

TABLE OF CONTENTS

	<u>Page</u>
I. <u>Reduced Costs to Customers</u>	4
II. <u>NEPOOL Reforms</u>	7
III. <u>Jurisdiction Over Transmission and Distribution</u>	8
IV. <u>Transmission and Distribution Pricing</u>	10
V. <u>Corporate Structure, the Divestiture of Generation, and the Standard Offer</u>	11
VI. <u>Municipal Light Departments and Load Aggregators</u>	13
VII. <u>Environmental Issues</u>	14
VIII. <u>Distribution Franchise and Reverse Metering</u>	15
IX. <u>Universal and Basic Service</u>	15
X. <u>Implementation of Unbundled Rates</u>	16
XI. <u>Stranded Cost Recovery</u>	17
XII. <u>Energy Efficiency and Renewables</u>	19
XIII. <u>Performance Based Regulation</u>	20
Conclusion	21

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Electric Utility Industry Restructuring

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D.P.U. Docket Nos. 96-100
and 96-25

**COMMENTS IN SUPPORT OF
OFFER OF SETTLEMENT**

These comments by New England Power Company (“NEP”), Nantucket Electric Company, and Massachusetts Electric Company (“Mass. Electric”) respond to the Department’s notice in this proceeding. The comments support the Offer of Settlement (“Settlement”) filed on October 1, 1996 in this case.¹ Specifically, the Comments demonstrate that the Offer of Settlement is consistent with the principles and proposed rules for industry restructuring developed by the Department and produces unbundled and retail access rates for Mass. Electric in accordance with the requirements set forth in Dockets D.P.U. 96-100 and 96-25.² Because the Settlement is “consistent with Department precedent and the public interest” and because the “overall effect of the settlement, on balance, [is] desirable for ratepayers and consistent with the

¹The Settlement in this case consists of five volumes. Citation will be to the volume and page number which is printed in the lower right hand corner of each page. The Settlement includes an Offer of Settlement by Mass. Electric to the Department (Vol. 1, p. 20) and a Stipulation and Agreement by NEP to FERC (Vol. 2, p. 2). Indexes of both Settlements are attached to these comments for ease of reference.

During the period since the Settlement was filed, we have identified several errata that are also attached to these comments. The changes correct cross references, add missing flow charts to Attachment 9, clarify language on environmental improvement commitments in Attachment 10, delete the page heading in Attachment 12, and eliminate the EMD lease charges from Nantucket Electric Company’s rates. The change to Nantucket’s tariffs will be completed formally in a compliance filing following the Department’s action on the Offer of Settlement.

²The record in these proceedings is extensive. The Department held hearings covering all issues associated with industry restructuring during June and July, 1996. In addition, the Department has conducted evening hearings on industry restructuring throughout the state in July and again in October of this year. In both dockets, Mass. Electric filed testimony and exhibits that document the effects of industry restructuring on Mass. Electric and NEP. These hearings and documentation provide a solid record for the Department’s evaluation of the Settlement in this proceeding.

overall direction of the Department's policies,"³ the Settlement meets the Department's standards and should be approved.

The Department's policy direction was set forth clearly and comprehensively in its May 1, 1996 Order of industry restructuring ("Order"). In that Order, the Department affirmed the principles it adopted for industry restructuring on August 16, 1995 in Docket D.P.U. 95-30 (Order, pp. 8-9), articulated a clear vision for the future of the electric utility industry, and established a series of concrete steps to implement the Department's goals. The Department's overall objective is "to develop an efficient industry structure and regulatory framework that minimizes costs to consumers while maintaining safe and reliable electric service with minimum impact on the environment" (Order, p. 8, quoting D.P.U. 95-30, p. 13 (Aug. 16, 1995)). The Department has set forth a series of issues and proposals to meet this objective and allow customer choice of electricity suppliers by January 1, 1998.

These comments follow the Department's order. As explained below, the Settlement proposal addresses each of the issues raised by the order in a manner consistent with the Department's policies. As a result, the Department's policy direction has fulfilled its intended function -- it has encouraged "further negotiations among Massachusetts electric companies and other stakeholders" and it has resulted "in settlements of the outstanding company-specific electric restructuring dockets." (Executive Summary, p. ix; see also Order, p. 7).

In this case, the list of signatories is extensive and comprehensive. The signatories include the Attorney General, who established the framework for the discussions; the Division of Energy Resources which added divestiture to the package; suppliers including the Northeast Energy and Commerce Association, American National Power, KCS Power Marketing, Inc., and U.S. Generating Company; public interest representatives from the environmental, low-income, and energy efficiency communities, such as the Conservation law Foundation, the Low Income Intervenors, Massachusetts Community Action Directors Association, Massachusetts Energy

³Boston Gas Co., D.P.U. 96-50 (Phase I), pp. 3-4 (Oct. 11, 1996) and cases cited.

Directors Association, Northeast Energy Efficiency Council, Inc., and the Union of Concerned Scientists; and customer groups including the High Technology Council and the Energy Consortium.⁴ The signatories include parties representing all aspects of the industry restructuring debate. The Settlement is a carefully constructed compromise of a range of specific issues by parties with different interests and perspectives. The resolution of these issues should be viewed as an integrated package. As explained below, the Settlement is consistent with the Department's policy goals and advances the restructuring of the utility industry. Accordingly, the Department should approve the Settlement in its entirety.

I. Reduced Costs to Customers.

The Department's primary goal for industry restructuring has been clear, straightforward, and consistent. As the Department stated in its August 16, 1995 order in Docket 95-30, p. 13 and reaffirmed on May 1, 1996 (Order, p. 8):

“Reducing costs, over time, for all consumers of electricity is the primary objective of the Department's efforts in restructuring the electric industry.”

The Settlement meets this primary objective. Under the Settlement, Mass. Electric's base rates are frozen prior to the Retail Access Date, and on the Retail Access Date, rates to customers taking standard offer service will drop by at least ten percent from the rates in place on October 1, 1996.

The decline in rates is demonstrated on Attachments 1 and 2 to the Offer of Settlement. Attachment 1 (Vol. 1, pp. 73-94) shows the typical bill calculations for customers during the period from January 1, 1997 through the Retail Access Date. As that Exhibit shows, the bills to

⁴ATC-CRSS, Inc. (American Tractebel) has also signed on to the agreement, and its signature page is attached to these comments. In addition, political leaders, the Associated Industries of Massachusetts, (10/15 Tr., pp. 127-32), the Worcester Chamber of Commerce, (10/15 Tr., p. 25), and several individual customers have expressed support for the Settlement. See e.g., 10/15 Tr., pp. 16-17 (Representative Peterson); p. 20 (Mayor Manca of Gardner); p. 25 (Mayor Mazzarella of Leominster); p. 58 (Mr. Good of Leggett & Platt); pp. 73-76 (Mr. Baker of Allmerica Financial); pp. 77-79 (Mr. Crowley of Polar Beverages); p. 80 (Mr. Fife of KomTek), pp. 81-82 (Mr. Andrews of the Worcester Business Development Corporation), pp. 83-85 (Mr. Egan of Carruth Capital Corporation).

customers in all classes at all levels of usage are the same as the rates in place in the third quarter of 1996. On the Retail Access Date, these bills drop by at least ten percent. As shown on Attachment 2 (Vol. 1, pp. 164-85), the difference in the percent of total bill column equals or exceeds ten percent for each customer class at each level of usage for all customers taking standard offer service.⁵ The ten percent decrease is also a reduction from the rates in effect in the third quarter of 1996. Moreover, the new rates eliminate Mass. Electric's fuel clause and roll its conservation factor into base rates. (Vol. 1, pp. 24, 31-32; compare Vol. 4, p. 4 with Vol. 4, pp. 165-67 showing fuel and conservation cost factors eliminated from tariffs). Under the rates for Standard Offer Service, adjustments are limited to a fuel index that can be triggered only after January 1, 2000 (Vol. 1, p. 26; Vol. 3, p. 48).

Actual savings to customers will be greater than ten percent when Mass. Electric's access charges are reduced through the residual value credit. Under the Settlement, the residual value credit must occur no later than three months after the sale of NEP's generating business, and, absent delays in the receipt of regulatory approvals, that sale is required to be completed within six months after the Retail Access Date. (Vol. 2, p. 7). The residual value credit produced by the sale is the only adjustment to the access charge in the first three years after January 1, 1998. It is not reflected at all in the calculation of the ten percent rate reduction.

In addition to the residual value credit, Mass. Electric's own distribution rates may be adjusted up or down to reflect the changes in tax laws or accounting rules (Vol. 1, p. 30), maintain equity earnings between 6 and 11 to 11.75 percent (Vol. 1, pp. 29-30), and adjust for changes in transmission costs (Vol. 1, pp. 30-31). These adjustments are the result of actions by independent parties, and are balanced adjustments that could produce increases or decreases in overall rates to customers. In addition, customers will receive a further reduction if Mass. Electric should fail to meet a performance standard. (Vol. 1, p. 29). Finally, customers buying

⁵The sole exception to the ten percent reduction is the streetlight rates. Streetlights include charges for lights and fixtures as well as for energy. Under the Settlement, total revenues for both components are held flat. (Vol. 1, p. 246).

electricity at market prices below the 2.8 cents per kilowatthour standard offer price in 1998 will realize even greater savings.

The overall rate levels produced by the Settlement are summarized in Exhibit 1 to these Comments. The column on the left shows Mass. Electric's prices today. Mass. Electric's average distribution costs total 2.6 cents per kilowatthour, its average transmission costs equal 0.4 cents per kilowatthour, and its average power supply costs including fuel are 6.9 cents per kilowatthour producing a total average rate of 9.9 cents per kilowatthour. Under the Settlement, Mass. Electric's base rates and NEP's wholesale rate to Mass. Electric are fixed through the Retail Access Date or January 1, 2001. (Vol. 1, p. 24; Vol. 2, p. 4). On the Retail Access Date, the average rates in the second column become effective. Distribution costs actually increase from 2.6 cents per kilowatthour (Vol. 1, p. 198, line 20) to 2.9 cents per kilowatthour under the rate settlement (id., line 19), producing a rate increase of \$46.7 million for Mass. Electric (id., line 15). However, the rate increase is more than offset by lower fixed cost recovery through the 2.8 cent per kilowatthour access charge (Vol. 1, pp. 26, 30-31, 221) and reduced energy charges through a 2.8 cents per kilowatthour standard offer price. (Vol. 1, pp. 26, 223). Transmission charges are expected to remain at the same 0.4 cents per kilowatthour (Vol. 1, p. 218), but are broken out and recovered in a separate reconciling adjustment. (Vol. 1, pp. 25-26, 30-31, 32). The result is an average rate equal to 8.9 cents per kilowatthour or ten percent below the current rates shown in column 1.

The economic value of the ten percent savings is maintained under the Settlement by freezing Mass. Electric's distribution rates through December 31, 2000 (Vol. 1, p. 25); freezing the 2.8 cents per kilowatthour access charge through December 31, 2000 subject only to the reduction for a residual value credit (Vol. 1, p. 26); and establishing a series of standard offer prices through 2004 subject only to a fuel price index that allows no adjustments during 1998 and 1999. (Vol. 1, p. 26; Vol. 3, p. 48, no trigger point until 2000). These fixed prices plus the

inflation cap for standard offer customers (Vol. 1, pp. 36-37) assure that the economic value of the initial rate reduction will be maintained over time. (See Exhibit 2).

As a result, the Settlement assures significant savings for all of Mass. Electric's customers, even those who stay with standard offer service. Customers also have full opportunity to realize greater savings through the market. Thus, the Settlement achieves the Department's primary objective (Order, p. 8) -- "reducing costs, over time, for all consumers of electricity."

II. NEPOOL Reforms.

In its May 1 Order, the Department focused on market structure and NEPOOL reforms including the creation of an Independent System Operator ("ISO"), power exchange, and Regional Transmission Group ("RTG"). The Department recognized that these reforms are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") (Order, pp. 14, 18), but found that meaningful reforms were central to the creation of a vigorous competitive market. (Order, p. 12).

During the hearings, progress on NEPOOL reform was continually updated (see, e.g., Mass. Electric's August 2, 1996, Comments, pp. 8-9). Ongoing discussions as of October 1, 1996 produced the NEPOOL Restructuring Proposal that is included in Attachment 11 to the Settlement. (Vol. 3, pp. 93-175). The NEPOOL reform proposal by NEP covers each of the issues identified by the Department in its Order. The proposal includes an ISO for the region with a separate governing board (Vol. 3, pp. 130-32), and defined operating responsibilities over both transmission (id. at pp. 132-33) and generation (id. at 133-34). The ISO is also proposed as the administrator of a power exchange (id. at pp. 134-36) and spot markets are proposed for capacity, energy, and ancillary services such as automatic generation control, operating reserves, and operable capacity. (Id. at pp. 138-67). Finally, the proposal describes the structure and operation of an RTG for the New England Region. (Id. at pp. 167-75).

Thus, the Settlement includes comprehensive proposal by NEP for NEPOOL reform that is consistent with the Department's policy objectives. However, under the Settlement, the proposal binds only NEP and Mass. Electric. (Vol. 1, p. 46). Approval of the NEPOOL Reform proposal is not a condition of the Settlement, and all parties other than NEP and Mass. Electric are free to advocate positions that are different from those included in the proposal. In short, the NEPOOL proposal is designed to be consistent with the Department's policy guidance, but approval of the Settlement does not bind the Department. Rather, the Department, as well as any other party, will be free to advocate or adopt positions other than those included in the NEP proposal in its own proceedings, and before regional groups and FERC. Thus, the Settlement moves the process of NEPOOL reform forward in a flexible way that does not bind the Department or the other parties to the Settlement.

III. Jurisdiction Over Transmission and Distribution.

In addition to NEPOOL reforms, industry restructuring and retail access require the delineation of a jurisdictional line between transmission facilities that are subject to FERC's jurisdiction, and distribution facilities that are subject to the Department's authority. The need for this jurisdictional separation was identified in the Department's order, and its proper implementation has become more critical since FERC's ruling on the pilot programs for Mass. Electric. Docket No. ER96-1626-000 (June 28, 1996). In that order, FERC exercised jurisdiction over facilities owned by Mass. Electric that had traditionally been viewed as distribution subject to the Department's jurisdiction.

The Settlement resolves this issue in a manner consistent with the Department's policy guidance. Specifically, Mass. Electric has completed an analysis of the FERC's seven factor test and the parties have agreed to support the resulting separation between distribution and transmission facilities before the Department and FERC. (Vol. 1, pp. 46-47; Vol. 2, pp. 11-12; Vol. 3, pp. 178-231). The analysis confirms the historical separation between the transmission

and distribution facilities on the Mass. Electric and NEP systems. If approved, the analysis will “allow for every retail electricity transaction in Massachusetts to include a component that is jurisdictional to the Department so that [the Department’s] policy requirements in restructuring will not be bypassable.” (Order, p. 19).

However, recognizing the factual nature of the inquiry, the lack of prior rulings on the issue, and the potential for conflicts between the Department’s findings and those of FERC, the Settlement is not conditioned upon approval without modification of the separation recommended in Attachment 12. Rather, the Settlement represents a recommendation of the parties, which the Department or FERC may modify without affecting the ongoing validity of the other elements of the Settlement. Thus, as with NEPOOL reform, the Settlement of this issue is consistent with the Department’s policy guidance, but its approval without change is not a condition of the Settlement.

IV. Transmission and Distribution Pricing.

The next issue articulated in the Department’s order focuses on comparability of transmission pricing. As the Department found (Order, pp. 20-21, footnote omitted):

“To achieve comparability in a competitive industry, the Department expects that distinctions between native load and third-party customers would be eliminated with respect to transmission pricing, terms, and conditions.”

This principle of comparability is the bedrock of the Settlement. At the transmission level, NEP’s transmission rate will be fully unbundled after the Retail Access Date, and NEP will provide transmission service to Mass. Electric under its open access tariff on the same basis and at the same prices that it provides service to its nonaffiliated transmission customers taking network service. (Vol. 2, pp. 10-11). The service agreement for the open access tariff is included in the NEP settlement (Vol. 2, pp. 86-93) and is consistent with the Service Agreement that NEP has implemented for all of its open access tariff network customers after FERC’s Order

888.⁶ Under the open access tariff, Mass. Electric expects to pay an average of 4 mills per kilowatthour for transmission or the same amount as NEP's other nonaffiliated network customers. (See Vol. 1, p. 219). Thus, the network transmission tariff provides access to all resources reaching NEP's multistate system at the same price, avoids pancaking on the NEP system, and avoids preferential treatment of native load over unaffiliated customers as required by the Department's order (Order, p. 21). With or without the RTG reforms that are under way, NEP's open access rates will assure comparable, nondiscriminatory transmission at both wholesale and retail consistent with the Department's policy guidance.

The comparability of treatment in the transmission terms, conditions, and rates is continued under Mass. Electric's distribution tariffs. The retail delivery tariffs included in Attachment 2 of Volume 1 and in Volume 4 (MECO and NEC 1998 tariffs) charge the same prices for transmission, distribution and access whether or not the customer purchases electricity supplies from Mass. Electric. Charges for standard offer service or basic service under all rates and for safety net service under the R-2 rate are separate adders to the retail delivery service rates, and the retail delivery service rates do not change based on the sources of supply. Accordingly, the settlement and the retail delivery rates fulfill the Department's objective for fully comparable transmission and distribution tariffs.

V. Corporate Structure, the Divestiture of Generation, and the Standard Offer.

The Department's concern with the development of a robust market among retail suppliers led it to favor the divestiture of generation from transmission and distribution. (Order, pp. 26- 27). Specifically, the Department found that divestiture "provides the cleanest solution to the problem of inappropriate and anticompetitive affiliate transactions" and creates "arms-length

⁶The transmission agreement and NEP settlement also include provisions that are designed to prevent bypass of the access charges under the Settlement. These antibypass provisions do not apply to NEP's municipal and other wholesale transmission customers who have not taken all-requirements service under Tariff 1 and who therefore are not responsible for the payment of contract termination charges.

transactions among generators, the ISO, and distribution companies [that are] apt to require the least regulatory supervision.” (Order, p. 27). As discussed below, divestiture also provides a complete market valuation of the generating business and a full mitigation of stranded costs.

Under the Settlement, NEP has agreed to divestiture in consideration for the full recovery of NEP’s contract termination charges and Mass. Electric’s resulting access charges pursuant to final approvals by the Department and FERC. (Vol. 1, pp. 47, 50-51; Vol 2, pp. 14-15, 17-18). Specifically, NEP has consented to “sell, spin off or otherwise transfer ownership of its generating business to a non-affiliated entity or entities.” (Vol. 1, p. 47). The sale includes all property that is not classified to the transmission function; it covers the properties of New England Energy, Inc., Nantucket Electric, and all of Manchester Street Station including the ownership interest of The Narragansett Electric Company . Even the generation from nuclear properties that NEP may not be able to sell or the power contracts that NEP is unable to assign must be sold into the wholesale market to non-affiliates unless the electricity is needed to meet NEP’s default or “zero bid” obligations under the standard offer. As a result, the Settlement completely separates the generation of electricity from transmission and distribution, and fully meets the Department’s objectives for corporate separation and restructuring.

Moreover, the wholesale supplies for transitional service under the standard offer must be put out to bid under the Settlement. This approach assures that all suppliers in the market are provided with an opportunity to supply customers during the seven-year transition period. It also provides value to customers through the lower prices that are fundamental to the Settlement,⁷

⁷Under the Settlement, the base prices that Mass. Electric pays for standard offer service in 1998 through 2000 are 4 mills per kilowatthour higher than the prices that Mass. Electric charges to its customers for standard offer service. (Compare Vol. 1, p. 26 with Vol. 2, p. 12; See Volume 3, pp. 45, 47). Much of this differential is expected to be made up through bidding by suppliers at discounts from the zero bid standard offer prices to suppliers. In the event that bids are not sufficiently low to make up the difference, the Settlement allows Mass. Electric to recover or defer operating losses. On the other hand, if discounts produce positive operating margins for Mass. Electric, these margins must be credited to all customers. (Vol. 1, pp. 34-35).

and assures that retail customers have a reliable supply option at a reasonable price during the transition period. Finally, the standard offer provides marketers with a concrete benchmark for creating and advertising retail prices, and it provides customers with a clear standard against which to evaluate the proposals of market suppliers. As a result, the standard offer should limit or eliminate much of the customer confusion that has occurred in pilot programs around New England.

The combination of divestiture, wholesale bidding of the standard offer supplies, and open retail competition to supplant standard offer sales to end use customers provides a procompetitive solution for reliable, stable-priced power supplies during the transition period. As a result, the revised standard offer incorporated in the Settlement now provides the advantages associated with standard offer service identified by the Department in its order (Order, p. 24) without slowing the “development of a robust market for generation” (Order, p. 23) which was the Department’s chief concern with the standard offer approach. Accordingly, the Department should find that the standard offer included in the Settlement is consistent with its policies and in the interest of customers.⁸

VI. Municipal Light Departments and Load Aggregators.

The Department’s Order also recognizes that its authority over municipal light departments is limited (Order, pp. 31-33), and accordingly does not require municipalities to open light departments for retail access. The Settlement is consistent with that approach. Under the Settlement, Mass. Electric is required to provide retail access on “the later of January 1, 1998, or the date on which retail access is made available to all customers of the investor-owned

⁸The Department’s Order also focuses on antitrust issues. (Order, pp. 27-31). The Settlement addresses these issues directly through divestiture of NEP’s generating business. The potential for horizontal market power by the buyer of the business will be addressed by the Department and other appropriate authorities at the time of the acquisition of NEP’s generation. To expand the population of eligible purchasers, the Settlement also includes findings necessary for NEP to become an exempt wholesale generator and its facilities to become eligible facilities under Section 32 of the Public Utility Holding Company Act. (Vol. 1, pp. 52-53; Vol. 2, p. 18).

utilities in Massachusetts.” (Vol. 1, p. 40, emphasis supplied). Nothing in the Settlement requires or conditions retail access by Mass. Electric on retail access by municipal light departments.

Moreover, nothing in the Settlement affects or restricts load aggregation undertaken voluntarily by municipalities or any other group or marketer. Rather, the rules and procedures developed by the Department pursuant to its Order will apply fully to marketers, aggregators and suppliers in Mass. Electric’s service territory. (See Order, pp. 34-35). Accordingly, the Settlement allows the marketing of electricity to proceed in a manner entirely consistent with the final policies established by the Department in this proceeding.

VII. Environmental Issues.

In its Order (pp. 35-39), the Department expressed concern about the potential environmental impacts of restructuring the industry. Accordingly, the Department “encourages the inclusion of voluntary emission reduction provisions in electric company restructuring plans. (Order, p. 37). The Settlement follows that policy guidance directly. As set forth in Attachment 10 (Vol. 3, pp. 81-91), NEP has agreed to significant reductions in emission of SO₂ and NO_x from its Brayton Point and Salem Harbor Stations. The emission reductions are tied to the fortieth anniversary of each unit’s entry into service (though in some cases the dates are accelerated), producing staged emission reductions from the entire fleet. (See Vol. 3, pp. 89-90). The emission reductions bind NEP’s successors and thus will continue following divestiture. (Vol. 2, p. 18). Moreover, the Settlement will not affect the authority of environmental authorities to impose stricter standards. (Vol. 1, p. 42). Accordingly, the Settlement directly responds to the Department’s policy encouraging emissions reductions as part of the Settlement process.

VIII. Distribution Franchise and Reverse Metering.

The Department's Order contemplates that Mass. Electric's distribution franchise will remain exclusive following the retail access date, and that the regulations authorizing reverse metering for small generators under 30 kilowatts will be reevaluated. (Order, pp. 39-42). The Settlement addresses both of these issues. Although the Settlement does not affect Mass. Electric's distribution franchise, it contemplates the collection of Mass. Electric's access charge through a fully reconciling charge. (Vol. 1, pp. 26, 32-33). As a result, existing contractual commitments in place to prevent distribution bypass are not affected by the Settlement, even though limitations on customers to purchase from alternative power suppliers are waived. (Vol. 1, pp. 37-40). Moreover, the limited carve out for small, under 30 kilowatt, cogeneration and renewable facilities is maintained, and these facilities remain eligible for net metering as authorized in existing Department regulations. (Vol. 1, p. 45).

IX. Universal and Basic Service.

The Department's order contemplates continued universal service for low income customers after the Retail Access Date, and the institution of basic service for customers in transition between suppliers. The Settlement requires Mass. Electric to provide both. Low income discounts for Rate R-2 customers are maintained (Vol. 1, p. 31); safety net service is provided for customers under rates, terms, and conditions approved by the Department (Vol. 1, p. 35); and anti-redlining protections are developed under which Mass. Electric assumes the bad debt risk from retail sales to Rate R-2 customers up to the prices in the standard offer. (Vol. 1, p. 45). In addition, all residential and G-1 customers are given a limited opportunity to return to standard offer service in the first year after the Retail Access Date. (Vol. 1, pp. 33-34). Finally, basic service is made available to all customer classes on terms that the Department finds to be reasonable. (Vol. 1, pp. 35-36). Accordingly, the Settlement fully responds to the Department's policies on universal and basic service.

X. Implementation of Unbundled Rates.

In its Order, the Department found that (Order, p. 47): “Implementation of unbundled rates for all electric companies is a necessary prerequisite to move to a restructured industry.” The Settlement meets that prerequisite. Under the Settlement, Mass. Electric implements revenue-neutral unbundled rates over the six month period beginning on January 1, 1997. (Vol. 1, p. 23; Attach. 1). The unbundled rates separately state an energy charge determined based on rate design and cost allocation techniques used in Mass. Electric’s last rate case. The Settlement also addresses the Department’s suggestion that utilities implement the proposal for marginal energy pricing by Boston Edison (Order, pp. 52-53), by requiring Mass. Electric to make this information available to customers upon request. (Vol. 1, pp. 23-24). Accordingly, the Settlement provides unbundled rates on a timely basis in a manner consistent with the Department’s policy guidance.

XI. Stranded Cost Recovery.

The Department’s policy on the recovery of stranded costs has also been clear from the outset. In its August 16, 1995 order (pp. 29-31) and its May 1, 1996 order, the Department found that “electric companies should have a reasonable opportunity to recover net, non-mitigatable stranded costs, and that companies must take all practicable measures to mitigate such costs.” (Order, p. 53). The Settlement achieves those objectives. The Settlement allows NEP to recover costs stranded by retail access through its contract termination charge to Mass. Electric (Vol. 2, pp. 6-9, 41, 48-81), but requires mitigation through a sale of the generating business with a full credit for residual value (Vol. 2, pp. 6, 14-15, 52-53), and through a separate termination charge incentive mechanism that increases NEP’s cumulative return on equity from a base of 9.4 percent when it reduces the cumulative average cents per kilowatthour of its contract termination charges to Mass. Electric. (Vol. 2, pp. 55, 65, 81). In addition, the Settlement allows Mass. Electric to

recover, through its access charge, the contract termination costs billed to it by NEP under the wholesale rate agreement. (Vol. 1, pp. 26, 32-33).

This recovery is consistent with the Department's Order. The Department's Order clearly encouraged the voluntary divestiture of generation both to ensure the efficient operation of the market and to provide a market valuation of the utility's assets. (Order, pp. 54-58). It has supported incentives for the mitigation of stranded costs. And it has consistently held that utilities should have a reasonable opportunity to recover net, nonmitigatable stranded costs. The Settlement implements those policies in a fair and efficient manner.⁹ The agreement expressly provides that divestiture is being undertaken voluntarily in consideration for the full recovery of stranded costs. (Vol. 1, pp. 50-51; Vol. 2, pp. 17-18).

As the Department recognized, nuclear entitlements present "unique costs and uncertainties associated with their generation, reliability, safety, decommissioning, and issues related to liability." (Order, p. 58). The Settlement addresses these issues in three ways. First, NEP may sell its nuclear units as part of the divestiture of the generating business. (Vol. 1, p. 28). Recognizing the difficulties associated with an outright sale, the Settlement allows NEP to assign ongoing operating costs and responsibility to a nonaffiliated third party on terms that may require NEP to retain the obligation for post-shutdown, decommissioning, and site restoration for the entitlements. (Vol. 1, p. 29). In the event that this second option is unsuccessful, NEP may retain the entitlements, but is required to operate them under a performance based plan under which customers pay 80 percent of the going forward costs of the units, including variable costs and capital additions, and receive 80 percent of the revenues from continued operation, with NEP sharing the remaining 20 percent of costs and revenues. (Vol. 1, pp. 29-30; Vol. 2, pp. 14-15,

⁹The calculation of NEP's contract termination charges is also consistent with the cost components allowed in the Department's Order. (Order, pp. 59-63). However, the Settlement extends stranded cost recovery beyond the ten years contemplated in the Department's rules. Specifically, fixed costs are recovered over twelve years and variable costs continue until the underlying obligations are terminated. (Vol. 2, p. 62). These changes to the recovery period were the direct result of settlement negotiations. However, it is possible that the recovery period for some variable components may be shortened if the buyer of NEP's generating business assumes the contracts and obligations in the variable component.

60-61). The performance based plan also includes a specific performance standard for nuclear safety indicators that NEP must develop after consultation with the Signatories to the Settlement. (Vol. 2, p. 61). Finally, the Settlement allows NEP to recover the nuclear decommissioning costs associated with its entitlements; however, this recovery excludes “any net incremental decommissioning costs caused by operations after the Retail Access Date.” (Vol. 2, p. 55). Thus, the Settlement carefully addresses the unique operational, safety, and public health issues associated with NEP’s minority interests in nuclear units in a manner consistent with the Department’s Order.

The final issue associated with stranded costs raised by the Department focuses on property taxes, and the potential impact on towns from the lower property values of generating plants after restructuring. (Order, pp. 63-64). The Settlement addresses this issue by allowing recovery through the variable component of the contract termination charge of all reasonable costs incurred by NEP or its affiliates associated with payments in lieu of property taxes to the cities and towns in which NEP owns generating facilities (Vol. 2, p. 59). Because these payments are unknown at this point, no specific estimate is included in the analysis. A similar treatment is provided for employee severance and retraining costs. (Vol. 2, p. 60).

XII. Energy Efficiency and Renewables.

The Department’s order also requires the continuation of support for demand side programs (Order, pp. 64-68) and the development of support for renewable energy sources. (Order, pp. 68-70). The Settlement addresses both issues. (Vol. 1, pp. 42-45). It requires Mass. Electric to file “annual budgets for demand side programs and clean renewables for the period 1998 through 2001 designed at \$66.7 million.” (Vol. 1, p. 42). The Settlement also allocates these resources to specific uses. Levels of support for low income residential programs and renewable programs are agreed to through the year 2001. Accordingly, the Settlement provides a concrete commitment of resources through December 31, 2001, when further action by the

Department is required. As such, the Settlement meets the Department's objectives for energy efficiency services and renewables.

XIII. Performance Based Regulation.

The final issue raised by the Department in its May 1 Order focused on pricing for regulated service and required utilities to implement price cap plans. (Order, pp. 71-76). The Settlement accomplishes that objective. Mass. Electric's unbundled rates are frozen at today's levels through the Retail Access Date. (Vol. 1, pp. 23-24). On the Retail Access Date, Mass. Electric is allowed a defined, one-time increase in its distribution rates after which its rates are frozen through December 31, 2000. (Vol. 1, p. 25). As explained at the outset, this distribution increase is offset by other elements producing a ten percent rate reduction for customers. Under any circumstance, Mass. Electric's total bills to standard offer customers cannot increase by more than the inflation cap through the end of 2004. (Vol. 1, pp. 36-37). As a result, Mass. Electric's rates are subject to an effective and comprehensive price cap under the Settlement.

Moreover, defined performance standards are put into place to assure that customer satisfaction and reliability are maintained. (Vol. 1, p. 29; Vol. 3, pp. 37-40). Mass. Electric is also required to develop a third standard for line losses. Each is designed as a penalty-only, minimum performance standard. If the Department adopts additional or more stringent standards for all electric utilities in Massachusetts, those standards will also apply to Mass. Electric. (Vol. 3, p. 38). Thus, as with many other components of the Settlement, the price cap plan and performance standards respond directly to the Department's policies in a manner that allows the Settlement to be adjusted to new requirements.

Conclusion.

For the reasons stated, the Department should find that the Settlement is "consistent with the Department precedent and the public interest" and that "the overall effect of the Settlement, on balance, [is] desirable for ratepayers and consistent with the overall direction of the

Department's policies." Boston Gas Co., D.P.U. 96-50, pp. 3-4 (Oct. 11, 1996). Accordingly, the Department should approve the Settlement in this case.

Respectfully submitted,

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